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DIRECTORATE OF  
INTELLIGENCE

# Intelligence Memorandum

*France: Balance-of-Payments Developments  
Since the Smithsonian Agreement*

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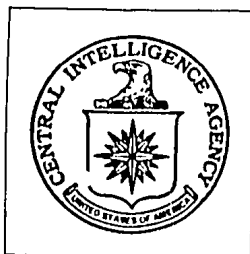
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**France: Balance-of-Payments Developments  
Since the Smithsonian Agreement**

France's balance-of-payments position in early 1973 is strong. Its exports retain their competitiveness in world markets, in large measure because the effects of domestic inflation and of the 1971-73 currency realignments have generally been less adverse to France than to its main trade rivals. Trade surpluses of better than US \$1 billion annually are keeping the current account in the black and the basic balance in near-equilibrium. France's traditional deficit in trade with the United States, however, will grow from the 1972 level of \$800 million annually as the dollar devaluations increasingly affect trade volume. This may strengthen French resistance to trade concessions favoring US interests.

The external payments position remains highly sensitive to volatile movements of short-term capital, but there appears to be no serious problem on the horizon. During recent periods of international monetary speculation, the franc has remained relatively strong, reflecting in part the healthy state of the economy. Continuing strength of the franc, moreover, is suggested by the results of the recent parliamentary elections, which appear to favor political stability and economic growth.

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## DISCUSSION

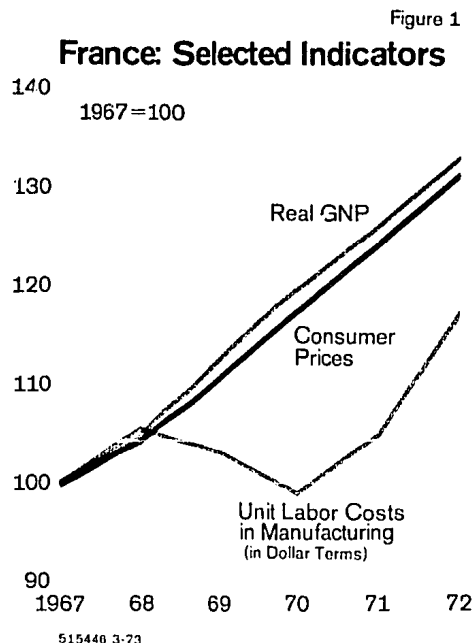
### Background

1. France's balance of payments\* fluctuated widely during 1967-71, largely in response to the civil disorders in May 1968 and the franc devaluation in August 1969. In 1968, capital flight, a sharp drop in tourism, and a weakening trade balance all combined to produce a record \$3.7 billion payments deficit (see Table 1). By mid-year, order had been restored and the strong GNP growth resumed. This brought a resurgence of confidence in the franc, and capital flows quickly reversed. But prosperity caused imports to rise far in excess of exports; the resulting trade deficit re-ignited capital outflows during the second quarter of 1969. These pressures led to the 11% devaluation of the franc in August 1969.

2. French exports, which had been increasingly handicapped by rapidly rising domestic labor costs, benefited as unit labor costs in dollar terms (see Figure 1) dropped sharply in the wake of devaluation. From 1969 to 1971, exports rose nearly twice as fast as imports, and in the latter year the trade surplus reached \$1.1 billion.

3. Although tourism did bounce back quickly from the sharp decline associated with the civil disorder of 1968, the deficits on invisibles remained fairly large because of adverse trends affecting other component accounts (see Table 3). The relative decline of France's merchant marine enlarged the deficit on transportation. Increasing payment of dividends to non-residents and interest payments on bank credits cut into traditional surpluses in the net investment income account. Finally, the increasing number of foreign workers in France, together with rising wage scales, resulted in a steadily increased flow of workers' remittances abroad.

\* In this memorandum the term balance of payments refers to the balance of official settlements unless otherwise stated.



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Table 1

**France: Balance-of-Payments Summary<sup>a</sup>**

	<i>Billion US \$</i>					
	<i>1967</i>	<i>1968</i>	<i>1969</i>	<i>1970</i>	<i>1971</i>	<i>1972 Estimates</i>
Current account balance	0.2	-1.1	-1.8	-0.2	0.5	0.5
Merchandise trade <sup>b</sup>	0.3	0.1	-0.9	0.3	1.1	1.3
Services and transfers	-0.1	-1.1	-0.9	-0.5	-0.6	-0.8
Long-term capital movements	Negl.	-0.9	0.2	0.1	Negl.	-0.7
Basic balance	0.2	-2.0	-1.6	-0.1	0.5	-0.2
Short-term capital movements <sup>c</sup>	0.1	-1.7	0.5	1.8	2.7	1.9
Allocations of SDRs	--	--	--	0.2	0.2	0.2
Official settlements balance	0.4	-3.7	-1.1	1.9	3.4	1.8
Official financing						
Change in official reserves	0.3	-2.8	-0.4	1.1	3.3	1.8
Net change in other official financing	0.1	-0.9	-0.7	0.8	0.1	0.1

a. Because of rounding, components may not add to totals shown. A more detailed balance of payments, with quarterly data for 1971-72, is presented in Table 2. Balance-of-payments data for 1967-70, in dollars, are from OECD sources. Data for 1971-72, originally expressed in francs, have been converted to US dollars at the rates shown in Table 5.

b. F.o.b./f.o.b. basis.

c. Including changes in commercial banks' foreign position; also net errors and omissions.

4. Long-term capital flows were generally close to equilibrium throughout 1967-71. During the 1968 crisis, however, outflows accelerated and inflows tended to dry up; the result was a \$900 million deficit for the year (see Table 4). The net outflow slackened later in 1968, but then picked up again the following spring as the franc weakened. After the August devaluation, the capital market returned to normal, and for 1969 as a whole there was a net inflow of long-term capital. The inflow dropped sharply in 1970 and virtually disappeared in 1971. This reflected not only the speculative attraction of the short-term market during the international monetary upheavals of 1971 but also a new and growing willingness of French business to invest abroad.

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5. Short-term capital flows exhibited a similar, although more pronounced, up-and-down pattern in 1968-69. The stampede of funds out of France which resulted from the civil disorders produced a \$1.7 billion deficit in the short-term capital account for 1968. Leads and lags in foreign trade payments contributed to the outflow. Turning about sharply after the May crisis, they generated a net capital outflow of \$320 million during the second half of 1968 and another \$550 million during the first half of 1969. With order restored, with the franc devalued and gaining a new aura of strength, and with interest rates in France relatively high, short-term capital inflows soared to \$1.8 billion in 1970 and to \$2.7 billion in 1971, when international monetary unrest was severe. The inflow was large for both bank and non-bank transactions.

6. By the eve of the Smithsonian agreement, France was in a favorable balance-of-payments position. There was an official settlements surplus of \$3.4 billion in 1971, and the prestige of the franc in international financial circles stood in marked contrast to the situation just three years earlier. A swelling trade surplus was covering deficits elsewhere in the current account. The basic balance, which is less sensitive than the official settlements balance to speculative distortions, was in substantial surplus. Moreover, the economy was continuing to grow rapidly, and the political climate was tranquil. Inflation was causing some concern and unit labor costs again tilted upward, but France's competitive position continued to improve somewhat because costs elsewhere in Western Europe were rising even faster.

**The Balance of Payments in 1972**

7. Although the value of the franc in terms of gold was not altered by the Smithsonian agreement, French trade faced a new spectrum of exchange rates in 1972. The West German mark and the guilder had been floating since May 1971 and the US dollar, since August. The Smithsonian agreement in December 1971 had formalized a new set of exchange rates that resulted in an average 1.8% net devaluation of the French franc in relation to the currencies of all its trading partners. The changes in the rates for the currencies of France's major trading partners are shown below in terms of the French franc:

	<i>Percent</i>
US dollar	-7.89
Italian lira	-1.00
UK pound	no change
Netherlands guilder	2.76
Belgian franc	2.76
German mark	4.61
Swiss franc	4.89

Relative to the currencies of the other EC countries, the devaluation averaged 2.8%. With respect to the currencies of the less developed countries, however, the franc was in effect revalued by about 2.5%.

8. Because the exchange rate realignment was quite small for the franc, the Smithsonian agreement had little impact on French trade last year. The franc's relative devaluation did slightly increase the cost of France's imports, but the trade balance was probably more influenced by the favorable delayed effects of the 1969 devaluation.

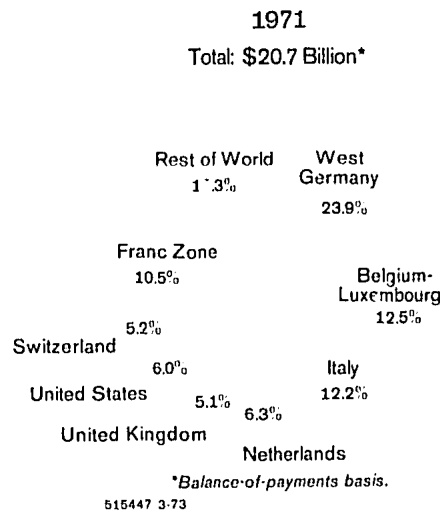
#### *The Current Account*

9. In 1972, French trade improved upon its remarkable growth of recent years. The trade surplus (f.o.b./f.o.b. basis) rose to a record \$1.3 billion. This, together with some increase in the deficit on services and transfer payments, resulted in a \$500 million current account surplus. In dollar terms, exports rose 25.4% and imports rose 25.9% during 1972. In franc terms the increases were about 8.6% less. Export volume was up 12.5% and import volume rose 11.5%. Price increases of 2.6% for exports and 4.0% for imports accounted for the remaining portion of the total increase in trade value. Trade expansion was rapid in all major categories: agricultural commodities led export growth, while for imports the leader was finished consumer goods.

10. France's foreign trade is heavily oriented toward its neighbors, particularly the five other members of the original EC. Together with the United States, Switzerland, and the United Kingdom, these countries account for more than two-thirds of French exports (see Figure 2). In recent years, France has run trade surpluses with only two of these countries, Switzerland and Italy. The surplus with Switzerland jumped 45% in 1972, surpassing \$600 million, while the surplus with

Italy increased slightly to about \$180 million. For the most part, France's trade deficits with its other major trading partners peaked in 1969 and

Figure 2  
**France: Major Export Markets**





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have since declined. France's largest deficit has generally been with the United States. This deficit reached \$950 million in 1970 but receded to about \$800 million in 1972. Trade with West Germany has recorded deficits since the mid-1960s. This deficit reached a peak of \$800 million in 1969, and in 1972 was only about \$459 million.

11. It is too soon for the Smithsonian rate changes to have had a substantial effect on French trade with any country. Even though the dollar and the deutschemark – among the currencies of France's major trading partners – underwent sizable changes relative to the franc, the US and West German shares of the French import market evidenced no discernible change during 1972. This is not surprising, however. There is a substantial lag in the response of trade flows to changed price relationships: in the case of the 1969 franc devaluation, approximately a year elapsed before the anticipated effects began to be seen in the flows of imports and exports.

12. Reflecting a marked decline in net investment income and a surge of workers' remittances abroad, the service and transfer payment balance worsened in 1972, to a deficit of some \$800 million. Net earnings from services, however, closely matched 1971's surplus of \$600 million. The \$1.4 billion deficit from transfer payments reflected a net outflow of about \$900 million of private funds and \$500 million of government funds.

### *Capital Flows*

13. Last year, France posted an overall surplus of more than \$1 billion in its long-term and short-term capital transactions. As in each previous year since the 1969 devaluation, the movements of short-term funds were dominant (see Table 4). The volume of international capital transactions continued to be affected by a variety of measures employed by Paris to insulate the domestic economy from international financial disturbances, including regulation of the foreign position of French banks and restrictions on foreign borrowing by French firms. Although the exchange controls were used during 1968-69 mainly to reduce capital outflows, more recently they have been applied primarily to restrict inflows. In both cases, however, the controls have been only partly successful. Sizable flows of capital have been diverted into channels such as leads and lags in trade payments. France also maintained its two-tier foreign exchange market throughout 1972. While the exchange rate for commercial transactions was held within the Smithsonian limits, the so-called financial franc was allowed to float. For most of the year, it maintained a level roughly three to four percentage points above the commercial franc (see Figure 3). Toward year's end, however, the premium on the financial franc had largely been eliminated, and both rates stood very close to the central rate.

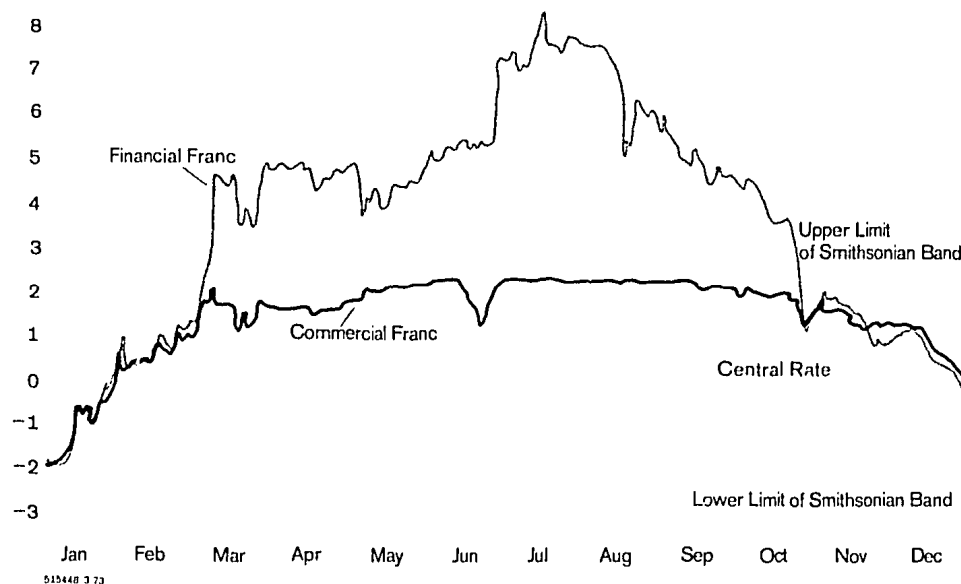
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Figure 3

**Franc-Dollar Exchange Rates in France's Two-Tier Market, 1972**

Deviation from Central Rate (in Percent)



14. The net outflow of long-term capital was about \$700 million during 1972. This deficit – the largest since 1968 – resulted mainly from banking sector operations, especially increases in long-term foreign loans and commercial credits. The banks' long-term foreign position shifted abruptly from approximate balance in 1971 to a deficit of \$700 million in 1972. Over the same period the surplus on private non-bank capital flows rose from \$200 million to about \$300 million. The main factor here appears to have been a surge of funds to the Paris Bourse that more than offset increased purchases of foreign securities by French residents. Direct investment flows apparently leveled off in both directions, leaving France with a net inflow in 1972 estimated at \$100 million – about half that for 1971. There was also a small net inflow of long-term loan funds.

15. Short-term capital inflow has been a major factor in French payments surpluses over the past three years. Leads and lags in trade payments generated about one-third of the net inflow during 1970-71 but were much smaller in 1972. The inflow of non-bank capital – \$2.2 billion during 1970-71 – dropped sharply once the speculative fever subsided following the Smithsonian agreement. For 1972 the inflow was nearly \$400 million. Net inflows of short-term funds in the banking sector

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(\$1.9 billion during 1970-71), however, increased during 1972, totaling \$1.4 billion for the year. The main factor here appears to have been French banks' borrowing abroad at relatively low interest rates in order to finance foreign exchange loans to their resident customers. Other circumstances contributing to the inflow were increases in franc deposits of non-residents, induced by the availability in France of relatively high interest returns and by the repeal late in 1971 of regulations on the banks' external position. By the end of 1972, however, the inflow of short-term capital appeared to have subsided, and, in fact, an outflow estimated at \$80 million was registered in the fourth quarter.

### Outlook

16. Prospects are good that France will maintain a generally favorable balance of payments in the next few years. But the surpluses are likely to be moderate enough in size that few calls for a franc revaluation will be heard. The magnitude of recent payments surpluses largely resulted from inflows of short-term capital. This could quickly be reversed if, for example, the political situation in France were to destabilize. Indeed, the reversal of short-term capital flows in the fourth quarter of 1972 and apparent continuation of the outflow in early 1973 was attributed by some to apprehension that the elections might result in a leftist government.

17. Underlying the expected continuing strength of the balance of payments is the improvement in France's price-competitiveness in recent years. Benefiting from the 1969 devaluation, unit labor costs in manufacturing in France remain well below those faced by its major European competitors (see Figure 4). Although wholesale prices in France are now climbing rapidly, spurring inflation elsewhere in Europe, together with recent exchange rate realignments, has left France with a relatively small cumulative rise in prices since 1967. Largely as a result of these factors, French export prices have risen less than those of most of its main competitors. Furthermore, when the franc was devalued in 1969, many French exporters apparently chose to increase their profit margins by raising franc prices rather than to pass the full benefit of devaluation on to their customers. This could mean that there is still an unexploited residue of the devaluation - that is, that French exporters could readily trim their profit margins and cut prices should export growth falter.

18. France's balance of payments should also benefit from the rapid growth expected in many other countries. During 1970-72 the French trade surplus grew in spite of the fact that the growth of real GNP slackened only slightly in France while a number of France's trading partners were experiencing marked recessions. In most of these countries, resurgent economic growth in 1973 is expected to result in marked expansion of

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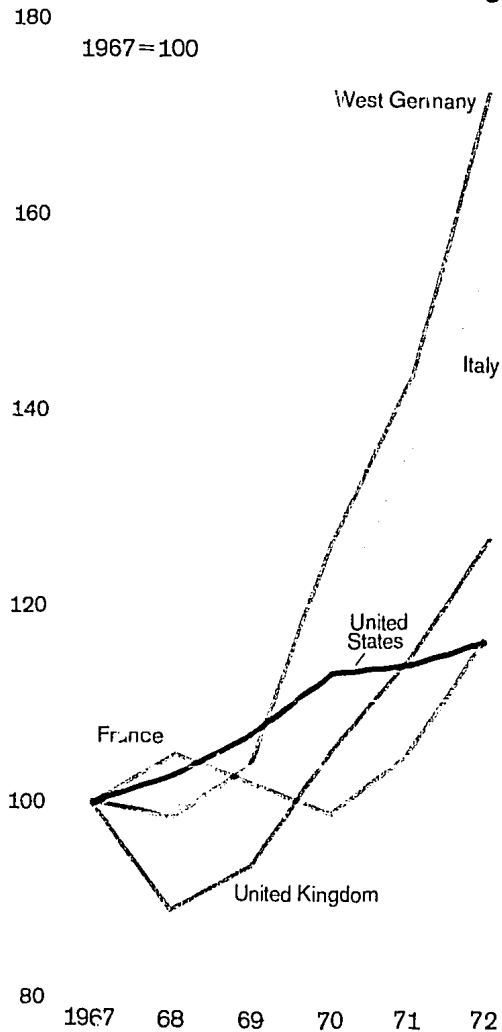
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Figure 4

# Factors Affecting Export Performance

In Dollar Terms

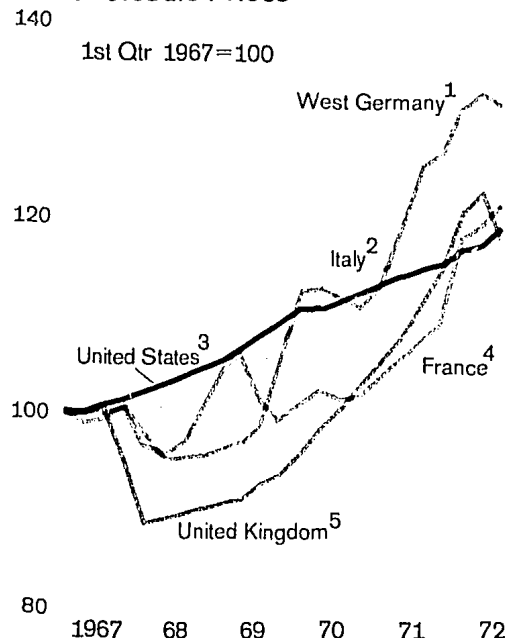
## Unit Labor Costs in Manufacturing



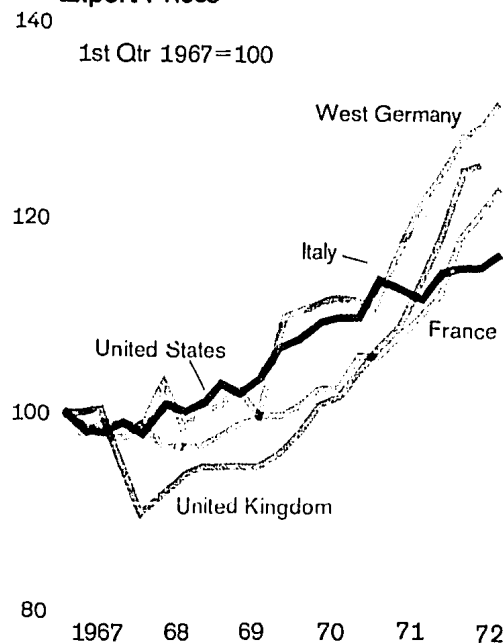
- 1 Producer prices, intermediate goods.
- 2 Non-agricultural goods.
- 3 Manufactured goods.
- 4 Intermediate goods.
- 5 Manufactured goods, home market.

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## Wholesale Prices



## Export Prices



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import demand, and French exports should benefit accordingly. With foreign trade headed for another excellent year – probably exceeding 1972's \$1.3 billion surplus – and the invisibles deficit stable, France's current account surplus is expected to increase to about \$1 billion in 1973.

19. The likely improvement in US export performance, as the December 1971 and February 1973 dollar devaluations influence foreign demand for US goods, will also make its mark on France's bilateral trade deficit with the United States. This deficit should narrow somewhat in 1973 because of the terms-of-trade effect of the latest devaluation. By the end of 1973, however, it will tend to widen again as the lower franc cost of US goods increases the volume of French purchases from the United States. This effect is likely to be pronounced because, for many products, the chief US competitor in the French market is West Germany. From the French importer's point of view, US prices have declined about 20% relative to German prices over the past two years. The US competitive position in France should be improved especially for such products as chemicals, machinery, electronic goods, pulp and paper, and agricultural products not subject to the EC's variable levy system.

20. The long-term capital balance should be aided by the French government's recent removal of restrictions on foreign borrowing by French companies. From August 1971 until the end of 1972 there was virtually a total ban on such borrowings, avowedly to reduce the flow of dollars into France. Foreign borrowing will now be permitted in cases where funds are not available in France and the proceeds are used to finance investment in the foreign country. An additional factor favoring long-term capital inflow is the absence of a substantial premium on the financial franc.

21. The political situation aside, short-term capital probably will be attracted to France by the relatively high interest rates now prevailing there. Toward the end of 1972, tighter monetary policies in most EC countries, including France, pushed interest rates up sharply. The situation is still relatively favorable to France, and a net inflow of short-term capital is likely to continue. But the volatility of short-term capital movements must be emphasized. Interest rates can change quickly, and, more importantly, fears of political change or exchange-rate realignment can erupt suddenly and trigger large flows of speculative capital.

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Table 2

## France: Balance-of-Payments Trends

Million US \$

Year	Current Account Balance	Long-Term Capital Movements	Basic Balance	Short-Term Capital Movements <sup>a</sup>	Allocation of SDRs	Official Settlements Balance	Change in Official Reserves	Net Change in Other Official Financing
1967	205	29	234	140	....	375	261	114
1968	-1,059	-898	-1,957	-1,708	....	-3,665	-2,793	-872
1969	-1,798	192	-1,606	546	....	-1,060	-313	-692
1970	-152	51	-101	1,848	165	1,912	1,127	785
1971	529	2	531	2,695	161	3,387	3,293	94
1st qtr	-38	-74	-112	378	161	427	530	-103
2nd qtr	126	1	127	446	....	573	165	408
3rd qtr	12	18	30	1,663	....	1,693	1,655	38
4th qtr	429	57	486	208	....	694	943	-249
1972 <sup>b</sup>	483	-668	-185	1,861	173	1,849	1,765	84
1st qtr	-315	-224	-539	619	173	253	216	37
2nd qtr	456	-171	285	664	....	949	929	20
3rd qtr	-28	14	-14	661	....	647	620	27
4th qtr <sup>b</sup>	370	-287	83	-83	....	0	0	0

a. Including net errors and omissions.

b. CIA estimates.

Table 3

## France: Current Account Trends

Million US \$

Year	Current Account Balance	Merchandise Trade			Services and Transfers						
		Net Balance	Exports, f.o.b.	Imports f.o.b.	Net Balance	Trans- porta- tion	Travel	Invest- ment Income	Workers' Remit- tances	Other Private Services and Transfers	Government Services and Transfers
1967	205	328	11,256	10,928	-123	223	-5	443	-450	436	-770
1968	-1,059	68	12,876	12,808	-1,127	-12	-132	308	-463	-29	-799
1969	-1,798	-859	15,144	16,003	-939	51	130	364	-519	-260	-705
1970	-152	320	18,010	17,690	-472	-14	210	365	-639	55	-449
1971	529	1,109	20,694	19,585	-580	-191	312	317	-706	283	595
1st qtr	-38	266	4,902	4,636	-304	-80	87	75	-139	-61	-186
2nd qtr	126	271	5,193	4,922	-145	-70	111	99	-185	83	-183
3rd qtr	12	238	4,824	4,586	-226	-5	4	57	-213	98	-167
4th qtr	429	334	5,775	5,441	95	-36	110	86	-169	163	-59
1972 <sup>a</sup>	483	1,295	25,951	24,656	-812	-129	327	159	-872	334	-631
1st qtr	-315	-39	6,035	6,074	-276	-58	80	33	-186	156	-301
2nd qtr	456	487	6,701	6,214	-31	-32	164	66	-207	99	-121
3rd qtr	-28	322	5,780	5,458	-350	-9	-17	10	-254	29	-109
4th qtr <sup>a</sup>	370	525	7,435	6,910	-155	-30	100	50	-225	50	-100

a. CIA estimates.

Table 4

## France: Capital Account Trends

Million US \$

Year	Long-Term Capital Movements				Short-Term Capital Movements			
	Net Balance	Private Non-Bank Capital	Change in Commercial Banks' Foreign Position	Government Capital Transactions	Net Balance <sup>a</sup>	Non-Bank Transactions	Change in Commercial Banks' Foreign Position	Net Errors and Omissions
1967	29	79		-50	140	-232	438	-66
1968	-898	-473	-354	-71	-1,708	-1,117	-557	-34
1969	192	317	-1	-124	546	-216	479	283
1970	51	614	-325	-238	1,848	984	500	364
1971	2	192	-13	-177	2,695	1,181	1,354	160
1st qtr	-74	-12	12	-74	378	125	229	24
2nd qtr	1	110	-77	-32	446	137	209	100
3rd qtr	18	45	0	-27	1,663	371	1,215	77
4th qtr	57	49	52	-44	208	548	-299	-41
1972 <sup>b</sup>	-668	266	-686	-248	1,861	376	1,372	113
1st qtr	-224	88	-211	-101	619	95	588	-64
2nd qtr	-171	134	-243	-62	664	113	419	132
3rd qtr	14	81	-32	-35	661	328	288	45
4th qtr <sup>b</sup>	-287	-37	-200	-50	-83	-160	77	0

a. Including net errors and omissions.

b. CIA estimate.



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Table 5

Exchange Rates: Francs per US Dollar

1971 annual average	5.53
1st quarter	5.55
2nd quarter	5.55
3rd quarter	5.55
4th quarter	5.48
1972 annual average	5.12
1st quarter	5.12
2nd quarter	5.12
3rd quarter	5.12
4th quarter	5.12

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